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Post-Brexit Strategies for UK Wealth Managers: The Allure of the GCC

Brexit means that the EU is no longer the default option for wealth managers expanding overseas; fast growth and an underserved market could make the Gulf Cooperation Council countries an attractive alternative. As firms plan their regional growth strategy, they should look to the long term. A robust, multi-jurisdictional investment and custody platform could be the best investment they ever make, writes Michael Rothwell, Country Manager at Pershing Channel Islands.

Higher costs associated with technology and increased regulatory requirements mean that economies of scale are becoming ever more important in the wealth management business. One solution to manage costs and improve efficiency is M&A: as a result, many markets around the world are consolidating. Another strategy is for wealth managers to expand internationally. Firms are increasingly seeking to offer similar products, on the same platforms, in as many markets as possible to optimise their return on investment.

The UK's wealth management industry is sophisticated and competitive: these characteristics have long helped it to succeed internationally. For UK providers looking overseas, the European Union (EU) has traditionally been the first port of call. Pre-Brexit, wealth managers doing business in sectors subject to MiFID could operate Europe-wide without any additional regulatory requirements. Now, however, firms must appoint a regulated custodian based in the EU27 (Pershing's operations in Ireland have helped many UK asset managers to comply with this requirement).

No doubt many UK managers will continue to look for EU opportunities, despite stiff competition and the need to appoint an EU-based custodian. However, for other UK-based asset managers seeking overseas growth, Brexit—and the consequent loss of passport—means that the EU is no longer the default option. In some regards, this has made growth outside the UK more challenging. However, by levelling the playing field when it comes to global opportunities, the upheavals caused by Brexit have given wealth managers pause for thought regarding the focus of their international ambitions.

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In a post-Brexit world, there are numerous jurisdictions which may potentially offer greater growth opportunities than the EU, while being no more difficult to access. Wealth managers need to be discerning in identifying opportunities, however. Necessarily, each market presents unique challenges. Moreover, costs relating to regulation, set-up, staffing, management of multiple locations and development of propositions to meet local requirements, currencies, languages and marketing can quickly add up. An international misstep has the potential to undermine the core business.

WHERE TO LOOK FOR GROWTH

One fast-growing region for wealth management, which offers a number of potential advantages for UK firms, is the Middle East. In the most recent figures available, Capgemini[1] calculates that the region recorded higher wealth growth than the global average in 2019 with the high-net-worth population increasing by 9.3% in 2019 and wealth growing by 10.2% to reach $2.9 trillion.

Within the Middle East, the most important group of countries is in the Gulf Cooperation Council (GCC), which comprises Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (UAE). While the GCC region's ultra-high net worth and high-net-worth investors have long had relationships with private banks based in the UK and Switzerland, there is a sizeable—and growing—wealth management market of mass affluent investors that are underserved.

This market is comprised both of locals and the expatriate population, which in the UAE, for instance, constitutes 90% of the population. While the majority of these expatriates are in low-income service or construction roles, a sizeable minority is well remunerated and therefore an attractive target for wealth management services. The wealth management sector in GCC countries is currently under-developed: locals are served by domestic banks that have limited product offerings; expatriates have access to few credible wealth advisers and services are expensive; by international standards, the quality of service is poor.

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In addition to targeting individual investors, one emerging opportunity relates to end-of-service gratuities. As expatriates are not eligible for pension contributions during their employment, traditionally they receive a lump sum when they leave their job (usually based on how long they have been in the role). These obligations sit on the balance sheet of employers and represent a considerable burden. The challenges created by such arrangements mean that many areas across the region, including Dubai, are currently looking at alternative solutions such as trusts and international savings plans (ISPs): regulatory change could create significant opportunities for wealth managers to manage investment portfolios for such trusts and ISPs.

UK institutions are well known and respected in the GCC, with established firms in financial services, petrochemicals, aerospace and many other sectors. For GCC citizens, UK institutions have a reputation for solidity and resilience: they are widely seen as well regulated, with robust risk management and controls. For expatriate investors, many of which are from the UK, there is an understandable preference for familiar and reassuring brand names, which are seen as a trustworthy source of financial advice.

AN EVOLVING LEGAL REGIME

All GCC countries have a legal system based on civil and Shariah law rather than the common law system used in the UK and the US. However, as GCC countries seek to broaden their economic base beyond commodities, many are focused on developing financial services. To attract international companies, a number of countries have in recent years introduced rules and regulations modelled on those applied in the UK and other common law systems for use in specific enclaves within their country. For example, both Abu Dhabi and Dubai have created free trade areas that use standard Anglo-Saxon legal structures and have UK-style dispute resolution mechanisms and a regulator modelled on the UK's Financial Conduct Authority. In addition, the UAE has recently passed a new law to create trusts—a first for a civil law jurisdiction—giving greater certainty to investors.

HOW TO TARGET THE GCC

UK wealth managers may ultimately seek to target multiple countries across the GCC. However, it can be advantageous to prioritise a specific jurisdiction in the first instance. While there are commonalities across GCC countries, their legal systems, languages, the degree of openness of their economies, and the receptivity of regulators to international businesses vary considerably. A pan-GCC approach to wealth management can facilitate economies of scale. But identifying a single country in which to launch—to develop a better understanding of local requirements—is advised.

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Similarly, while many wealth managers will aim to target both GCC citizens and expatriates across the region in the long term, it may be advisable to target a specific client group initially. Each client group has differing requirements and preferences. For example, GCC citizens may require Shariah-compliant investments or have different lifestyle objectives to expatriates. Similarly, expatriates may be more interested in particular asset classes or have tax considerations that relate to their eventual return to their native country. Client interaction and marketing must be tailored to each group accordingly. One cost-effective tool recently deployed by wealth managers in the region is social media, which is popular among the young and technologically savvy GCC and expatriate investor base.

For many wealth managers, it may be possible to establish a business without a physical presence in a country, visiting local advisers, financial planners or other relevant parties during visits. However, such an approach is unlikely to be viable in the longer term: both locals and expatriates will expect to see an asset manager make a commitment to a market by hiring local professionals (whether GCC citizens or expatriates), establishing a local office, and (for GCC citizens) developing local language support. Ultimately, these steps can also be valuable in order to develop a deeper understanding of domestic markets and establish strong local connections via local social, sporting and other events (this can be especially important when dealing with high-net-worth individuals).

WHY WORK WITH A CUSTODIAN IN THE CHANNEL ISLANDS?

For wealth managers entering GCC countries, using a custodian outside the UK, the EU or the US offers tax advantages which allow them to meet customers' requirements and allay their concerns. For example, GCC citizens want to keep assets offshore to the UK or US to avoid creating inheritance or estate tax exposure while expatriates are keen to manage their needless exposure to UK taxes whilst living abroad.

Local regulators in the GCC are amenable to international wealth managers deploying offshore custody arrangements. One ideal custody location is the Channel Islands; Pershing Channel Islands is based in Jersey, a self-governing dependency of the United Kingdom off the coast of France. Jersey has a sophisticated infrastructure with an established network of internationally recognised law, accounting and professional financial services firms and other support services as well as one of the fastest broadband networks globally.

The ease of doing business and the legal structures that underpin business relationships in the Channel Islands match those of the UK. However, the jurisdiction's tax neutrality compared to the UK—combined with decades of political stability and a government that prioritises financial services—ensures that wealth managers choosing the Channel Islands as the location for their custody services get the best of both worlds.

CHOOSING THE RIGHT CUSTODY PARTNER

Regardless of the client group or jurisdiction chosen by a UK wealth manager for its first launch in the GCC, given the size of individual markets in the region, most companies will ultimately seek to expand their offering to multiple countries. To do this cost effectively, asset managers need to work with a custody provider that offers a platform, technology and operational business support to underpin their offering wherever they seek to do business within the GCC. Furthermore, it is important that a custody partner has relevant experience in the region, a long-term track record in meeting the needs of investors globally, and a history of consistent investment in technology and its offering.

An effective custody provider, such as Pershing Channel Islands, is able to perform the vast majority of the technology, reporting and other requirements associated with operating in a new jurisdiction on behalf of its wealth management clients. Investment management firms simply have to select a market and develop a strategy. Critically, Pershing can offer these services on a multi-jurisdictional basis, ensuring that wealth managers do not have to duplicate arrangements as they expand into additional countries in the GCC. Moreover, by using a single platform, firms can ensure greater visibility and control of client money across the region as well as streamlined reporting for regulatory and other reasons.

While wealth managers operating in GCC countries will necessarily manage operations on a regional basis, it can be valuable to use a technology platform familiar from other regions. Pershing's offering has considerable commonalities across the Channel Islands, the EU and the UK. While each regional offering is adapted for local conditions and regulations, the solution looks and feels the same, has been developed with the same fundamental architecture, and is maintained by the same IT teams. Consequently, wealth managers can leverage their existing workflows and rapidly get up to speed as they expand in the GCC. While Pershing adapts its offering to each jurisdiction, it has a highest common denominator policy when it comes to regulatory standards, providing reassurance to wealth managers and their clients.

[i] https://www.capgemini.com/nl-nl/wp-content/uploads/sites/7/2020/07/World-Wealth-Report-WWR-2020.pdf

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pershing.com/emea

Registered Office:

Royal Liver Building, Pier Head, Liverpool L3 1LL

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